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## BURDENS OF FALSE CAPITALIZATION

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There are two distinct classes of investors: one by preference, the other per force. Every one of us is now an investor by force of circumstances. Investors in the corporate enterprises of the United States may be grouped:

First, those who hold bonds and stocks and get the interest and dividends thereon. Second, those who have in reality supplied the invested capital, or a large part of it, but with nothing to show for what they have done, have the added and continued burden, as consumers, of paying transportation rates and prices for commodities such as are necessary to yield income on securities representing no real investment by the first place holders.

Capitalization of American enterprises may be divided roughly into two forms, that resting on real cash investment or actual created property, and that looking to the public and the future to find value. This last is false capitalization. It may be justified in some sense, certainly as to part of it, by the financial necessities of the projects which it was created to create.

Be that as it may, the whole body of false capitalization, to the extent that it draws income, adds just that much, directly or indirectly, to the aggregate cost of living. Let us freely admit that there was excuse for certain issues of securities which stood for no investment. They at all events, resulted in the carrying out of development projects of infinite public value.

There have been other and vast issues of corporate securities which can not be so justified. They came into being not to help in the financing of any worthy enterprise. They were created essentially as a means of making available for use now, profits to accrue from labor to be performed in time yet to come, and of foisting upon the future the task of liquidating that sinful waste of extravagant living indulged in by beneficiaries of a scheme of financing, cleverly devised to cash in on accumulated wealth and to discount our children's enterprise.

This system has resulted in the quick creation of enormous fortunes, but at the same time it has piled up an unwieldy and dangerous mass of credit obligations. This aggregation of so-called securities which the present generation has created in its selfish greed for the use of more wealth than it has created or will, presses upon us of today, and passes forward, not as a birthright, but as a birth-inherited burden for our children and their children to carry or to cast aside in indignation and very despair.

Economic and financial problems of the hour have particularly to do with results and consequences of the flotation of securities having a claimed value of billions of dollars, but which rest upon nothing more tangible than the earning power, now and hereafter, of the issuing companies. And this earning power often, if not generally, depends upon either a monopoly position or the willingness of the public to pay excessive rates or prices for the services or products of such companies.

Accept these premises and logic forces the conclusion that the people can destroy, just as easily as they now sustain, a volume of corporate obligations created as the easiest, safest way to exploit the many for the profit of the few. In many cases the sins committed in the initial capitalization of industrial concerns were so palpable that efforts were made at atonement, that is, by putting more real value into the properties capitalized, so as to strengthen the position of the stockholders. In this process the public has supplied the capital, but has nothing for it.

The greatest example of this is the United States Steel Corporation. From the time it started, April 1, 1901, capitalized at \$1,403,-000,000 upon tangible properties which the federal Bureau of Corporations could find to have been worth not more than \$682,000,000, this corporation, to the end of 1912, applied \$551,335,535 of profits in filling out the difference. Such is the measure of the investment by the public in the steel business to make good the false capitalization of this greatest industrial corporation launched on \$682,000,000 of property submerged under \$721,000,000 of water. And during the period that the \$508,302,500 of common stock was thus being given value, still further profits paid \$149,927,382 in dividends to holders of such stock.

Now for the general propositions. Time was when actual property value was looked upon as the safe and true measure for capitalization. This theory was first abandoned in an important way in the

capitalization of railroads built into unopened territory and largely as projects of development.

Capital had to be induced to embark in such enterprises, in which risks and even hazards ran hand in hand with, and often far ahead of success. For the construction of nearly all such pioneer lines it was necessary to meet the demands of capitalists. They wanted more than ordinary returns. In fact, they demanded terms big with promise. They would take bonds issued to finance construction cost only at heavy discounts.

Nor was that all. With such bonds there was very commonly issued a like amount of stock. This had no value when issued, nor did it amount to anything more than a call upon the future. Such bonus stock was retained as far as possible by those who promoted the issuing railroad. Part of it was in most cases demanded by the capitalists who furnished the construction capital. They wanted some stock to give them a larger income than they could get, as holders of fixed income securities, in the expected event that the railroad proved successful.

Present-day railroad financing is generally being done upon a clean basis. Fortunately for all concerned, and not least, the public, the established properties are in position to finance on reasonable terms. They are able to build extensions, to make improvements, to provide additional equipment, without those sacrifices of the future which many railroads were driven to make in the earlier days.

For the best and largest development of the country, the railroad system must be maintained, operated and expanded so as to provide safe and adequate transportation. If the railroads are to perform their functions in a way which the public has just right to require, they must earn revenue sufficient to provide the services and to pay whatever is a fair return on the capital which must yet be invested in railroad property.

The carriers and those who own railroad securities should have fair treatment. So must the public. On June 30, 1911, our total railroad capitalization was \$19,208,935,000, of which \$3,495,916,000 received no return. Eliminating inter-company and so duplicated holdings, the net capitalization was \$14,434,309,000. Opinion differs widely as to what relation the value of the railroad system of the country bears to this capitalization.

Last year a New Jersey commission found that the seven principal companies had properties in that state with a present value of \$343,-201,589, carrying \$357,346,186 of capitalization. Commissions of Washington, South Dakota, Michigan, Minnesota and Wisconsin have valued the railroad properties in those five states at \$1,021,950,-881, against which the capitalization was \$1,276,949,698, or one quarter in excess of the valuation.

Property created out of retained profits from railroad operation, and so contributed by the public, may not properly be made the basis for capitalization, and thus a further charge upon the public. That marks one dividing line between reasonable and extortionate transportation rates. When the railroad exacts more than is necessary to pay for what it does and to return fair income on the capital investment, the rates cease to be right charges for services performed and become taxes to be resisted.

But it has been in the industrial rather than in the transportation field, and mainly during the last fifteen years, that the great bulk of new capitalization upon earnings, present and prospective, has taken place. In this process an enormous total of securities—many being securities more in name than in reality—have been created and foisted upon the world.

Total capitalization of United States corporations, other than railroads, now exceeds \$20,000,000,000. A tabulation for 1910 showed a total of \$17,530,000,000, of which \$4,400,000,000 were bonds and \$13,130,000,000 stocks. Upon this huge aggregation \$760,000,000 was paid as interest and dividends.

Not a few of these capitalizations have fallen of their own weight, and many more depend upon the willingness of the public to continue to bear the burden of false financing which took place when property values were ignored and earning power was taken as the basis for capitalization.

It by no means follows that we are getting things cheap because the prices are small. But it is necessary that articles shall be sold at unduly high prices if false capitalization is to be made valuable through dividends.

In 1901 the Cambria Steel Company was refinanced to raise required new capital. There was issued \$45,000,000 of stock. This represented \$17,370,000 cash paid. To justify the new capitaliza-

tion the old properties and assets were re-valued, being by this simple process marked up \$27,630,000.

Since then dividends have been paid at rates ranging from 7.7 up to 13 per cent on the actual cash invested by the stockholders of the Cambria Steel Company. In the same time the public, buying the products of the concern, has unconsciously invested \$19,635,226 in the business. Thus the public has supplied to the company a substantially larger amount of real capital than its stockholders have invested.

This has been made possible through prices which have yielded the company big profits. Had it been otherwise, the corporate owners would have been obliged to provide the large new capital which has been required. In many cases the capital provided by the public, in its everyday payment of big profit prices, has been actually capitalized to the corporate owners. When this happens, the public, having made the capital investment, is next called upon to pay dividends on the stock issued free to others.

These acts of false capitalization have borne hard upon the mass of the people, and continue to do so. Yet to destroy the corporation idea because it has been often and outrageously abused and in ways to put undue and wrong burdens on the many, would be but to inflict worse injury upon them.

Industrial and business activities are not possible without combination in less or greater degree. From no true economic standpoint is it desirable that such combination should be destroyed. Breaking down combination of human effort will never be tolerated by thinking people. While civilization exists there will be combination, for combination is association, and without that the human race must be reduced to its primal state, in which individualism was the mainspring of action.

Diversity of occupation, which alone renders possible the largest progress of mankind, came slowly, laboriously, painfully. Only gradually was evolved that high specialization of effort which has made man master over the great resisting forces of nature, forces which, brought into subjection and made to serve the increasingly manifold purposes of mankind have made our present civilization.

Only through association, which established the prerequisite basis for diversity of effort, will man be enabled to retain his present mastery over nature. Alone and by himself, he becomes an impotent

weakling. In that state of isolation his very existence is in the balance.

Man in association with his fellowmen becomes free and powerful. His condition improves, his life becomes easier, his time is made more his own, and new opportunities open for the exercise and display of mental powers, for cultivation of esthetic tastes and for the unfolding of the spiritual in the human composition.

In the light of what has been and is, taking help from the lessons of history and the teachings of profound minds, resting on the demonstrations of reason, the human race dare not now overthrow that naturally evolved economic system of life which has raised mankind to its present-day position.

Some good and earnest, but mistaken people, would strike down every combination, of whatever character. Such action would be a terrible blow to human civilization and would inevitably turn backward the course of progress. There must be found a remedy which is not destructive to human advancement, but to the daring evils which have sprung up in the body politic. Good things are often subverted to foul uses.

The most beneficent of nature's products can become veritable scourges. Water and air, when they gather as floods and cyclones, destroy ruthlessly everything within reach of their tremendous fury. The locomotive is a thing of immense utility so long as its power is applied under control; but let it escape from human command, and it tears a path of destruction.

Quite the same is it with human-made combinations. They rest upon the broad and sure economic principle that association is essential to man's life and progress in the larger sense. Kept within control and made to serve the true end of combination, which is economy in production and distribution, combinations give fuller life and health to the people as a whole. As such they are to be sustained, encouraged and protected. When, through the operation of human selfishness, they are diverted from the straight path of usefulness and converted into high-power engines, worked to exploit the many for the benefit of the few, then civilization's greatest moving force—association—becomes, instead of the uplifter of mankind, a dire power of blighting nature.

With the gradual development of the corporation, with the progressive concentration into the hands of a few of dominating, and, as

it is, often dominant, power over the financial, industrial, commercial and transportation activities of the nation, combination—a natural development of human life—has been brought to do the remorseless, savage work of grinding the life-blood out of the great mass of the people. They have been made the tools for their own exploitation. And so, combination, turned to wrong use, has come to be regarded as a thing vicious in itself, an enemy to mankind.

But it is neither one nor the other. What must be done is not to kill combination, but to bring it into subjection and to turn its huge power to the uses of the whole people. Then will combination perform its natural and proper work when it promotes the welfare of mankind.

There should be a general and fairly relative partnership of all the people in the products of combinations which spring into being as the natural, certain means of accomplishing various work to the best economic advantage. Those who organize and direct great combinations of human effort are justly entitled to large material recompense. Those whose labor and intelligence are joined in making the enterprise a working and producing success deserve their proportionate share of the results. Those who invest in its securities are entitled to a return on their investment commensurate with its nature. Further, those in other ways and elsewhere engaged in productive or any needful or useful service, are not less entitled to participate in the benefits of the combination in which they may have no direct interest.

We have given the Interstate Commerce Commission power to keep transportation rates reasonable. Another natural step will be to set a limit on trust profits and so on the prices which they may charge for their products. With the rights of the public so asserted, false capitalization will fall of its own weight, as wrongful profits vanish.

We must not willfully or in anger destroy the values of securities now outstanding. On the other hand, consumers have rights which must be upheld if our civilization is to stand. There has got to be evolved a better and more equitable system for dividing the fruits of human toil and enterprise. In such system, false capitalization, imposing wrongful taxes on the toiling, striving millions, and adding to the cost of living, can find no place.